EIR Economics

Deadly cure: currency board urged on Mexico's Zedillo

by Carlos Cota Meza

In the aftermath of his February trip to Great Britain and Switzerland, the Mexican government of President Ernesto Zedillo now faces the choice between applying protectionist economic measures, or falling into the abyss, by embracing the financial oligarchy's new "solution": to dismantle the national credit system and replace it with a foreign-controlled currency board, along the lines of what Argentine Finance Minister Domingo Cavallo implemented in 1991.

Mexico's policy dilemma mirrors the reality of the disintegrating international financial system, which is reaching a crossroads defined by its own dynamic of collapse. At least some sectors of the international financial oligarchy have realized that their "traditional policies" are no longer sufficient to keep their crumbling structure intact.

By "traditional policies," we mean the International Monetary Fund's (IMF) well-known conditionalities—floating exchange rates, currency devaluation, increased exports, wage freezes, and budget cuts, among others—implemented to guarantee payment of the cancerous foreign debt. In Mexico's case, following the December 1994 peso devaluation, in 1995 the application of these classic IMF conditionalities barely kept the "free market" economic model in place, at the cost of destroying the country's productive physical economy and exacerbating the national banking system's generalized insolvency. Inexorably, what is on the horizon for mid-1996 is another explosion of the Mexican debt bomb.

Faced with this crisis, the Mont Pelerin Society—a gang of bandits with academic credentials who call themselves neo-conservatives in the United States and neo-liberals in most other places in the world—is organizing internationally with a proposal to eliminate central banks in most of the developing sector nations and replace them with currency boards. Argentine Minister Domingo Cavallo's reputation has been bolstered by the public relations line that his imposition of a currency board was what allowed Argentina to weather the "tequila effect" triggered by Mexico's 1994 peso devaluation.

There is no unanimous sentiment in favor of the currency board option for Mexico among the financial establishment, however. For example, during a recent trip to Mexico, former Federal Reserve chairman Paul Volcker publicly opposed the currency board idea, arguing that what Mexico needs is "a certain degree of flexibility in its exchange rate." Similarly, in statements made from Washington, Treasury Undersecretary Lawrence Summers advised that Mexico would do better to concentrate on strengthening its economy, rather than debating "secondary issues such as what type of exchange rate it should have."

The debate between protectionism of the national economy, and British-sponsored "free trade" havoc, is not unique to Mexico. It has been ignited in the U.S. electoral campaign, as well as in Russia's volatile economic and political climate, to name only the strategically most powerful places.

Zedillo in London

One of the most disturbing aspects of President Zedillo's recent tour of Europe was his private meetings with Bank of England Governor Eddie George. At the Bank's offices, he also met with William Purves, president of Midland Bank,

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and Hongkong and Shanghai Bank Holding Co. Not only is HongShang Bank the historical controller of Asia's opium trade; today it also controls Hongkong's currency board. No official communiqué was issued following these meetings, but their effect is being felt in Mexico.

Thanks to the revelations published in the daily *El Financiero,* Mexicans learned that former students of University of Chicago professor Arnold C. Harberger, would be attending an exclusive meeting in Mexico. Supposedly speaking as private citizens, many of the Mexicans among these students, most of whom work for the central bank (Bank of Mexico), were going to analyze the "future" of the country's exchange rate policy.

The seminar, entitled Alamos Alliance III and run by the California-based Pacific Academy of Advanced Studies whose chairman is economist Clayburn LaForce, took place at the end of February at the posh Casa Pacífica ranch owned by the Robinson Bourghs family in the small town of Alamos, Sonora. Early in this century, the family, of Dutch descent, set up its own private bank at the ranch which, among other things, issued its own currency! The only scheduled speaker at the event was Bank of Mexico Governor Miguel Mancera Aguayo. Also in attendance were Roberto Salinas-León, chairman of the Mexican Mont Pelerin Society, and Carolina Bolívar, president of the Mont Pelerin-linked Ludwig von Mises Cultural Institute. Among the seven or more American "academics" attending were John Sweeney of the Heritage Foundation and Michael Walker, director of the Fraser Institute, both entities associated with the Mont Pelerin Society.

A large number of these individuals participated in the Mont Pelerin Society's mid-January meeting in Cancún, Mexico. The most highly publicized aspect of that event was the intervention of Johns Hopkins University professor Steven H. Hanke, the most vocal proponent of creating currency boards in Ibero-America.

Hanke's proposal

In an interview published in the Jan. 17, 1996 *El Economista,* Hanke went berserk against the Bank of Mexico, lauding Argentina's 1991 Convertibility Law which he personally authored, and attacked those who oppose currency boards. Hanke argued that contrary to a system based on central banks, with a currency board "the lender of last resort is foreign capital." Responding to the objection that without a central bank, all national monetary aggregates would have to be backed by foreign reserves (in Mexico's case, $100 billion), Hanke said "a currency board can be created without having to cover 100% of old deposits with reserves. The new deposits are the ones that would have to be covered . . . in that sense, the only thing the currency board does is to establish total freedom to choose a currency and take away the government's monopoly over issuance of the legal currency."

In reality, what Hanke is proposing for Mexico is what his book, *Currency Boards for Developing Countries,* calls "The Alternative: A Parallel Currency Approach." To establish a monetary system parallel to the national currency, Hanke says: "A parallel currency is one that circulates extensively alongside another currency at exchange rates determined by market forces. The parallel currency can have a fixed, pegged, or floating exchange rate with the other currency and can circulate legally or illegally."

To put a parallel currency into circulation, Hanke proposes: "An easy method is to give every resident an equal amount of currency board notes and coins as a one-time gift. . . . For example, a certain amount for the first person in each household, a lesser amount for each additional adult, and a still lesser amount for each child. . . . Residents who receive their distribution of currency can have their identity documents stamped or have their fingers dipped in indelible ink."

Hanke proposes the "legal" conversion of a central bank to a currency board in the following manner: Delegate to other institutions all the functions of the central bank, *except* supply of the monetary base; allow a brief period of a clean exchange rate, with no restrictions, for domestic currency; convert commercial bank deposits at the central bank into the currency of the currency board or into foreign instruments; establish a fixed exchange rate using the currency board's currency; guarantee foreign reserves equal to 100% of the domestic currency in circulation; and transfer the central bank's remaining assets to the currency board.

A crucial aspect of Hanke's proposal is that the currency board's board of directors would be made up of five individuals, three of whom would be foreign nationals appointed by the International Monetary Fund, and therefore considered trustworthy by foreign bankers!

To make the case for his model, Hanke discusses the first currency board created in 1849 in Mauritius, a British colony in the Indian Ocean. In 1900, other British colonies, and Argentina, adopted the same model. After 1900, "currency boards became the monetary arrangement of choice for British colonies and for some independent developing countries." Currency boards reached "their greatest extent in the 1950s, when much of Africa, the Caribbean, and South Asia had currency boards." In Eastern Europe, a currency board was set up in the northern region of Russia around Archangel and Murmansk in 1918 and 1919 and, Hanke reports, "kept an office open in London until 1920."

Historically, Hanke asserts, the currency board systems "have typically been successful in encouraging foreign investment"; in reality, the historical examples he chooses offer the worst cases of hyperinflation, civil wars, and bloody imposition of British looting practices.

Bank of Mexico under attack

Once President Zedillo's European tour concluded, the campaign against the Bank of Mexico began in earnest. There

are many reasons why the bank's elimination might be justified, but they are not the ones cited by the British Empire's financial pirates.

The IMF recently sponsored a conference entitled "Latin America's Central Banks within a New Legal Framework," held in Santa Fe de Bogotá, Colombia. Here, Ernesto Aguirre, an adviser at the IMF's legal department, chastised Mexico as the worst example of a country which granted autonomy to its central bank but then prevented the bank from handling monetary policy. According to the IMF, fights have erupted among financial authorities in those countries which have "constitutionally" created autonomous central banks.

Roberto Junguito, deputy director of Colombia's Banco de la República, spoke on behalf of the IMF. He asserted that "autonomous central banks will face serious difficulties in the future," and emphasized that "the executive branch should have no interference whatsoever in the decisions of a central bank; by the same token, no finance ministers, undersecretaries, or financial planning secretaries should be granted veto power."

According to some Mexican members of the Mont Pelerin Society, Ariel Buira, one of the Bank of Mexico's deputy governors, had a "strong exchange of words" with Steve Hanke at the offices of the *Financial Times* of London last year, which is why Hanke had not returned to Mexico until the Cancún conference in January. In July of 1994, Hanke and Sir Alan Walters had proposed that the peso be devalued and a currency board set up in Mexico. Buira and Sergio A. Ghigliazza, director of the Bank of Mexico's Monetary Studies Center, attended the Bogotá conference where, of the 17 central banks represented, 80% rejected the imposition of currency boards in their respective countries!

On the other hand, Francisco Gil Díz, another of the central bank's deputy governors, for the first time has spoken of "the need" to consider a currency board for Mexico to counter speculative attacks such as that of 1994. Gil Díz and Agustín Carstens, the central bank's director of Economic Research, recently presented a study to the American Economic Association in San Francisco, California, on "the causes" of the Mexican crisis. For this gang of Bank of Mexico officers, the crisis was due to "having maintained a fixed exchange rate without establishing a currency board."

Almost daily, more Mexican traitors embrace this scheme. Following the Alamos gathering, members of the Mexican Institute of Financial Executives showed up in Washington in the company of Steve Hanke and James Dorn of the Cato Institute. Hanke insisted that Mexico must create a currency board "before it is too late," adding that questions of "sovereignty" are irrelevant compared to the need to correct policies of Mexico's central bank which he called "one of the world's worst."

The "solutions" the IMF has imposed on Mexico to contain the banking system's growing insolvency, have not only exacerbated it, but have de facto fulfilled many of the "prerequisites" Hanke demands for creating a currency board.

Everyone recognizes that all the emergency programs and the billions of dollars spent by the government to prevent the national banking system's collapse have failed. It is an open secret that the finance minister and the National Banking and Securities Commission are frantically working on new schemes to prevent a massive banking collapse. These new plans consist of effectively placing Mexican bank assets under *foreign control,* whereby the new foreign banks operating in the country will accumulate more capital than the foreign reserves held at the Bank of Mexico which for the most part come from IMF loans.

In practice, these new plans have consisted of handing over the four largest Mexican banks, controlling over 60% of the national banking and financial market, to foreign "partners," while smaller banks merge or simply disappear. The Mexican government is also seeking to sell to the same foreign banks the bank assets of which it gained control through the Bank Protection and Savings Fund (Fobaproa).

Banamex and Bancomer, Mexico's two largest banks controlling 50% of the market, began 1996 with the sale of their debt portfolios to the federal government. Due to "legal and accounting adjustments to be completed," Banamex has not yet sold $15 billion of its debt portfolio to Fobaproa. Bancomer sold $15.6 billion of its portfolio to Fobaproa and then immediately announced its "association" with the Bank of Montreal, founded in 1826, which acquired 16% of the Mexican bank with an option to increase this to 55%. Bank of Montreal, in turn, owns Harris Bank of Chicago, the fourth largest bank in the state of Illinois.

Forty-eight percent of Banco Inverlat, Mexico's fourth-largest bank, had already been absorbed by Fobaproa. The federal government has announced that Inverlat will associate with Canada's Bank of Nova Scotia, which will acquire 55% of its assets. Mexico's third-largest bank, Banca Servin, is owned by Adrián Sada González, a leading figure of the Monterrey Group. No information is available on the bank's status to date, but in 1995, it was the most important bank to join Fobaproa. It had sought a merger with Inverlat, but the Bank of Nova Scotia wouldn't agree to it. From all appearances, it is already under control of Bancomer-Bank of Montreal.

The remaining banks, almost all either totally or partially run by Fobaproa, are being dismantled, having their assets sold (bankers call this "disinvesting") to national or foreign insurance companies, brokerage houses, and the like. Moreover, the Finance Ministry has authorized 17 foreign multibank institutions to operate freely in the country. Also under way is the "conversion" of national bank assets to foreign financial instruments. New owners of Mexican banks, in addition to the 17 foreign institutions operating in the country, will back up new bank deposits with foreign exchange. Those same banks are the ones which will take out of the Mexican government's hands its monopoly over currency issuance.